

**CORPORATE EXPROPRIATION FROM THE  
PERSPECTIVE OF OWNERSHIP  
CONTESTABILITY AND BOARD GOVERNANCE  
IN MALAYSIA**

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**UNIVERSITI SAINS MALAYSIA  
2018**

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by

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**Thesis submitted in fulfilment of requirements  
for the degree of  
Doctor of Philosophy**

**January 2018**

## **ACKNOWLEDGEMENT**

I thank the ALMIGHTY for having bestowed the blessing on me to complete this thesis successfully.

Foremost, special thanks to my supervisor, Dr Abdul Hadi Zulkafli, for his motivation, encouragement, patience, and guidance in supervising my research right from beginning. He has strongly encouraged me to work harder to do my research through his invaluable advice, support, interest and constructive comments. I would have never made this far without his supervision. I take this opportunity to express my deepest appreciation and gratitude to Dr Abdul Hadi Zulkafli.

I would like to thank Dr Phua Lian Kee, Dr Chee Hong Kok and PM Dr Hooy Chee Woi for their constructive comments for this research. I would like also to thank to Dr Effiezal Aswadi Abdul Wahab, Dr Khairul Anuar Mohd Shah, Dr Kamarun Nisham Taufil, Dr. Ahmad Rizal Mazlan, Dr Nanthakumar, Dr Wan Nazri, Dr. Hashim Jusoh, En. Mohd Jaffri Abu Bakar and En. Ahmad Rizal Razali for their valuable input, support, and kind assistant in this study.

I would also like to thank all my colleagues at School of Management, Universiti Sains Malaysia for their assistance, invaluable discussion, suggestions and friendship. In particular i would like to thank Dr. Doddy Setiawan, Dr. Mohd Nasir Selamat, Dr. Amar Hisham, Rozaidy, Dr. Dudy Permana and Dr Rayendra Kresna Brahmana. I would thank to the staff of School of Management for helping me in administrative matters and supplying resources needed for my research work.

Last but not least, I wish to thank my wife, Siti Sabarina Che Wil, for her support, understanding, patience and sacrifices throughout my study. To my son: Imam Taqiy and to my daughter: Nur Al Iman, thank you for supporting me and providing endless affection and time throughout my study. To my parents, thank you for support and love.

Ahmad Husni Hamzah

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## **LIST OF ABBREVIATIONS**

ADB	Asian Development Bank (ADB)
AOB	Audit Oversight Board (AOB)
CMSA	Capital Markets and Services Act 2007 (CMSA)
CS	Controlling Shareholder
DPR	Dividend Pay-out Ratio
DPS	Dividend per Share
EPS	Earnings per Share
IFI	Islamic Financial Institution
IMF	International Monetary Fund
IPC	Infrastructure Project Corporation
OECD	Economic Co-operation and Development
KLSE	Kuala Lumpur Stock Exchange
MSS	Multiple Shareholders Structure
PLCs	Public Listed Companies
SCS	Single Controlling Shareholder
SIDREC	Securities Industry Dispute Resolution Centre

# **EKSPPROPRIASI KORPORAT DARI PERSPEKTIF PERSAINGAN PEMILIKAN DAN TADBIR URUS LEMBAGA PENGARAH DI MALAYSIA**

## **ABSTRAK**

Tesis ini mengkaji kesan persaingan pemilikan dan tadbir urus lembaga pengarah terhadap ekspropriasi korporat di Malaysia. Objektif kajian ini adalah untuk menyelidik samada kehadiran struktur pemegang saham pelbagai dan tadbir urus korporat memberi kesan yang kuat terhadap terhadap ekspropriasi korporat dalam kalangan syarikat tersenarai di Malaysia. Secara khususnya, kajian ini menjurus ke arah mengenalpasti kesan pemilikan satu pemegang saham kawalan dan tadbir urus lembaga pengarah terhadap ekspropriasi korporat, kesan pemilikan pemegang saham kawalan dan pemegang saham besar; dan tadbir urus korporat lembaga pengarah terhadap ekspropriasi korporat dan pemilikan pemegang saham besar sahaja dan tadbir urus lembaga pengarah terhadap ekspropriasi korporat. Dengan menggunakan regresi data panel, tesis ini menganalisa syarikat-syarikat yang tersenarai di Bursa Malaysia dari tahun 2008 hingga tahun 2012. Hasil kajian ini merumuskan bahawa pemegang saham kawalan yang kuat mempunyai kawalan yang signifikan ke atas syarikat yang menjadikan mereka lebih dominan dalam membuat keputusan syarikat seterusnya meningkatkan pendedahan ke atas ekspropriasi korporat. Dapatan ini juga mendapati bahawa darjah pertama persaingan pemilikan tidak memberi kesan sebagai alat untuk mempengaruhi ekspropriasi korporat. Pada darjah kedua persaingan pemilikan, hasil kajian ini menunjukkan bahawa kehadiran dua pemegang saham besar dapat menyaingi kuasa pemegang saham kawalan dan menghasilkan tekanan untuk mempengaruhi ekspropriasi korporat. Sementara, itu, pada darjah ketiga persaingan pemilikan, memberi kesimpulan bahawa kehadiran lima pemegang saham besar tidak berkesan



untuk mengurangkan ekspropriasi korporat. Berkaitan dengan peranan lembaga tadbir urus; struktur lembaga pengarah, kepelbagaian lembaga pengarah dan imbuhan kepada lembaga pengarah, dapat disimpulkan bahawa saiz lembaga pengarah yang besar secara positifnya mempengaruhi ekspropriasi korporat dalam keadaan tiada persaingan pemilikan korporat (LSH). Disamping itu, peranan ahli lembaga pengarah bebas sebagai mekanisma tadbir urus dalaman tidak memberi kesan dalam kedua-dua keadaan samada tanpa persaingan dan dengan wujudnya persaingan pemilikan korporat. Analisa dalam kepelbagaian lembaga mendapati bahawa ahli lembaga pengarah asing berfungsi sebagai mekanisma tadbir urus dalaman dalam kedua-dua keadaan samada tanpa persaingan (LSH) dan dengan adanya persaingan pemilikan (CONT2 dan CONT3). Selain itu, kehadiran lembaga pengarah wanita tidak berfungsi sama sekali sebagai mekanisma tadbir urus dalam kedua-dua keadaan samada dalam keadaan tanpa persaingan dan adanya persaingan pemilikan pemilikan korporat. Disamping itu, penemuan bertentangan antara kesan langsung dan kesan interaksi menghasilkan bukti yang tidak konklusif mengenai hubungan antara imbuhan kepada pengarah dan ekspropriasi korporat. Kesimpulannya, persaingan pemilikan dilihat berfungsi dengan berkesan sebagai alat untuk mengurangkan ekspropriasi oleh pemegang saham yang mengawal pada tahap tertentu iaitu pada darjah kedua persaingan pemilikan.

**CORPORATE EXPROPRIATION FROM THE PERSPECTIVE OF  
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MALAYSIA**

**ABSTRACT**

This thesis examines the effect of ownership contestability and board governance on corporate expropriation in Malaysia. The objective of the study is to investigate whether the presence of multiple shareholders structure and board governance have significant impact on the corporate expropriation of Malaysian PLCs. Specifically, the study is directed towards identifying the effect of ownership of only controlling shareholder and board governance on corporate expropriation, the effect of ownership contestability between controlling shareholder and large shareholders; and board governance on corporate expropriation and the effect of ownership of only large shareholders and board governance on corporate expropriation. Using panel data regression, this thesis analysed listed firms in Bursa Malaysia from 2008 to 2012. The findings of this study infers that the powerful controlling shareholder who has significant control over the firm enables them to dominate the decision making process and hence increases firm's vulnerability towards corporate expropriation. It is also found that the first degree of ownership contestability is ineffective to become a tool that influences the corporate expropriation. At the second degree of ownership contestability, this findings signify that the presence of two large shareholders could contest the power of controlling shareholder and produce more pressure to influence corporate expropriation. Meanwhile, at the third degree of ownership contestability, it infers that the presence of five large shareholders is ineffective in alleviating corporate expropriation. With regards to the role of board governance: board structure, board

diversity and board remuneration, it can be concluded that large board size is positively influenced corporate expropriation in the setting of non-contestability of corporate ownership (LSH). In addition, the role of independent director would not effective as internal governance mechanism in setting of both non-contestability and contestability of ownership structures. Analysis on board diversity indicates that foreign board members functions as internal governance mechanism in both situations of non-contestability of corporate ownership (LSH) and contestability of corporate ownership (CONT2 and CONT3) structures. Moreover, presence of female board member does not work at all as an internal governance mechanism in the setting of both non-contestability and contestability of corporate ownership structure. Furthermore, contradictory finding between direct effect and interaction term generates inconclusive evidence on the relationship between board remuneration and corporate expropriation. In conclusion, contestability of ownerships appears to function efficiently as a tool to alleviate expropriation by controlling shareholder under certain extent which is at second degree of ownership contestability.

# **CHAPTER 1**

## **INTRODUCTION**

### **1.1 Background of the study**

Corporate governance is defined by Denis and McConnel (2003) as a set of mechanisms, involved in organization's decision-making with the objectives to maximize the organization's value and to increase shareholders' wealth. Thus, every action and decision taken by the company is intended to provide benefits to all the shareholders of the company. This is the same as that expressed by Shleifer and Vishny (1997), where "corporate governance deals with the ways in which suppliers of finance to corporation assure themselves of getting a return on their investment". In corporate finance, corporate governance is also a mechanism to protect the shareholders from expropriation of wealth by the controlling shareholders (Claessen, 2006). This has motivated many corporate governance studies been carried out at firm level, focusing on the role of multiple shareholders and boards of directors. This view is also supported by Llopis, Gonzales and Gasco (2007) who stated that corporate governance is related to standard compliance by a firm which includes the relationship between the board of directors and the shareholders

The Asian financial crisis in 1997 and the collapse of WorldCom companies in the early 2000s have resulted in re-emergence of corporate governance issue. In the WorldCom companies' debacle, several giant corporations such as Enron, Pharmalat and Tyco collapsed due to lack of corporate governance. Later, several other large corporations around the world were declared bankrupt. In 2008, the high profile

financial “supermarket” Lehman Brother Holdings collapsed as a result of weak corporate governance particularly on the part of the shareholders. After the Lehman Brother’s episode, many countries have taken further steps to strengthen their corporate governance systems (Mallin, 2007). In addition, international agencies such as the Economic Co-operation and Development (OECD), International Monetary Fund (IMF), World Bank, United Nation (UN) and Asian Development Bank (ADB) have enhanced and updated standards and practices of corporate governance to ensure that what happened in the past will not recur in the future.

Malaysia has taken several initiatives to strengthen its corporate governance system since 1996. It began when the Kuala Lumpur Stock Exchange (KLSE) introduced the directors Code of Ethics. This was followed by the establishment of Malaysian Code of Corporate Governance in the year 2000 (MCCG 2000) in order to restore investors’ confidence after Asian economic crisis in 1997. In addition, in 2001, Bursa Malaysia Listing Requirement requires all listed companies to include a Corporate Governance Statement in their annual report. This is to ensure that all public listed companies comply with all the guidelines as required by the Bursa Malaysia. In addition, Minority Shareholder Watchdog Group (MSWG) was established to further enhance corporate governance, where it serves to protect the interest of minority shareholders relating to their rights. Furthermore, MCCG was revised in 2007 and several amendments related to the board of directors have been made. Moreover, Malaysian Code of Corporate Governance in the year 2000 (MCCG 2000) also issued a guideline in 2008 related to listing of companies on KLSE in order to have good corporate governance practices. This guideline is also linked with the board of directors in order to ensure the integrity and public accountability of public listed company’s directors. In 2009, Securities Commission (SC) has introduced sections

317A and 320A of Capital Markets and Services Act 2007 (CMSA) to enhance corporate governance. According to The Reporter SC (2010), Section 317A empowers the SC to act against errant directors and officers of Public Listed Companies (PLCs) for causing wrongful loss to the company. Section 320A, on the other hand, allows SC to act against anyone who influences the preparer and auditor of financial statements, causing them to be false and misleading. The Audit Oversight Board (AOB) has been introduced in 2010 to develop a robust audit oversight framework for Malaysian over PLCs. The recent new body, Securities Industry Dispute Resolution Center (SIDREC) has been set up by SC in early 2011. This new body will enhance investor protection by affording investors with small claims on settlement of disputes without the need to resort to expensive litigation (Tan Sri Zarinah Anwar, SC Chairman).

MCCG 2012 was the first major deliverable of Corporate Governance Blueprint 2011 that focuses on strengthening board structure and composition recognizing the role of directors as active and responsible fiduciaries. The MCCG 2012 adopted a new structure which provides for greater clarity, more information to companies and allows for simpler reading. In essence, each principle in MCCG 2012 is followed by recommendation and commentaries. The recommendations are specific standards that contribute towards the principles. Every recommendation is followed by a certain commentary which seeks to explain and assist companies in understanding the recommendation. The MCCG 2012 has included some of the best practices from the MCCG 2007.

Many of the corporate governance weaknesses that have resulted in companies' failure are due to the conflict of interest between managers and shareholders. This conflict, which arises because of separation of ownership and control leads to agency problem (Berle and Means, 1932). As a result, the shareholders wealth maximization

objective cannot be achieved in the long run. This is further reinforced by Jensen and Meckling (1976) who stressed that agency problem will exist in a firm when the shares are not fully owned by the manager. However, the agency problem can arise not just between shareholders and managers, but also between controlling and minority shareholders, between shareholders and creditors and between controlling shareholders and other stakeholders (Fama and Jensen, 1983; Shleifer and Vishny, 1997; Morck, Nakamura and Shivdasani, 2000; Bebchuk, Kraakman and Triantis, 2000; La Porta, Lopez-de-Silanes, Shleiffer and Vishny, 2000; Holderness, 2003).

Grossman and Hart (1980), and Shleifer and Vishny (1986) looked at monitoring role of large shareholders as a possible solution to agency problems that arises from the separation of ownership and control in public corporation. Gomes and Novaes (2005) and La Porta, Lopez-de-silanes and Shleiffer (1999) highlighted the importance of monitoring role played by large shareholders in the company. Interestingly, Gomes and Novaes (2005) introduced sharing control among large shareholders as a new corporate mechanism. According to Mitton (2002), large shareholders use their power and incentive to avoid expropriation by controlling shareholder. In addition, Zhong Gribbin and Zheng (2007) reveals that the effectiveness of monitoring by outside blockholders on managers have positive impact on firm's earning.

There are many factors that can affect corporate governance such as corporate ownership structure, economic, legal, social, political and cultural factors. In firm's perspective, mechanisms of corporate governance can be seen in terms of internal and external mechanisms (Zulkafli, 2007). The internal control mechanisms are corporate ownership structure and board of directors while take over and market for corporate control and legal systems are external control mechanisms in the firm (Denis and McConnell, 2003; Cremers, Nair and Wei, 2004; Claessen, 2006). The key

determinants of corporate governance system are corporate ownership structure, composition and operations of the firms (Singam, 2003). It seems that corporate ownership structure and board of directors are the important mechanisms in influencing the internal corporate governance in the company as highlighted by Fama (1980), Jensen (1993), Shleifer and Visny (1997), Denis and McConnell (2003), Cremers et al. (2004) and Claessen (2006).

Although numerous studies have been conducted to examine the various issues of ownership structure, hardly any of them focused on the impact of contestability and board governance on corporate expropriation. This is quite surprising considering the fact that ownership is a key mechanism in corporate governance. Malaysian PLCs have been identified as having high concentrated ownership structure (Claessens et al., 1999; World Bank, 1998; Claessens, Djankov, Fan and Lang 2000; Ishak and Napier, 2004; Mohd Sehat and Abdul Rahman, 2005; Abdul Wahab and Abdul Rahman, 2009). The existence of multiple shareholder structure (MSS) is due to the concentrated ownership structure where the firms controlled by single controlling shareholder accompanied by other large shareholders or firm controlled by several large shareholders. In firms with highly concentrated ownership structure, the controlling shareholders have significant power and incentive to expropriate corporate resources for their own benefit (Saez and gutieerez, 2015; Bennedson and Wolfenzon, 2000; Claessens et al., 2000; La Porta et al., 1999). The presence of several large shareholders and coalitions among large shareholders can be formed resulting in increased contestability by large shareholders in order to curb the power of controlling shareholder to expropriate fund for their own benefit. Therefore, this study is motivated by the issue of ownership structure focusing on contestability of large



shareholders and board governance that could have significant impact on expropriation issues in the firm.

## **1.2 Problem Statement**

The issues of expropriation by controlling shareholders and large shareholders have been debated extensively for example by Pagano and Roell (1998), Bennedsen and Wolfenzon (2000), Gomes and Noveas (2001), Giterrez and Tribo (2003), Maury and Pajustee (2005), Attig, Guedhami and Mishra (2008) and Saez and Gutierrez (2015). This phenomenon occurs because normally, the party who holds a large amount of stock in the firm is the one who has significant control of the firm. The expropriation occurs when the controlling shareholders have both the ability and incentive to deflect fund for their own benefit (Krishnamurti, Sevic and Sevic, 2005). According to Le Breton-Miller and Miller (2009), expropriation of wealth by controlling shareholders is one of the important manifestations of type II agency problem and the cost of expropriation has positive relationship with ownership structure (Krishnamurti et al, 2005).

As indicated earlier, generally previous studies have found that Malaysian PLCs are dominated by controlling or large shareholders and they have highly concentrated ownership structure (Claessens et al., 1998; World Bank, 1998; Claessens et al., 2000; Abdul Samad 2002, Mohd Sehad and Abdul Rahman, 2005; Zuha Abdul Rahman and Mahenthiram, 2009). Almost one third of Malaysian PLCs is dominated by blockholders (Abdul Wahab, 2006), and approximately 56% of Malaysian PLCs' shares are in the hands of blockholders (Mohd Sehat and Abdul Rahman, 2005). In addition, Ishak and Napier (2004) documented that controlling shareholder dominated around 66% to 97% of Malaysian PLCs in three different cut off points; 5%, 20% and 50%. In addition, Classens et al. (2000) pointed out that roughly 41% of Malaysian

PLCs are held by single large shareholders. It is suggested that concentrated ownership increases the potential for the expropriation of minority shareholders' wealth by controlling shareholder. The high level of ownership concentration increases the propensity for expropriation of minority shareholders by controlling shareholders as mentioned by Shleifer, Andrei and Robert (1997). Malaysian PLCs are exposed to the risk of expropriation by controlling shareholder due to highly concentrated ownership structure. Therefore, based on the relevant evidence, the issue of expropriation by controlling shareholders is an important issue that needs to be addressed in Malaysia particularly with respect to the contestability of large shareholders against the controlling shareholder in the firm. This party is commonly known as the controlling shareholders and it also has considerable control on firm's policies (Loh and Mat Zin, 2007). Controlling shareholder has substantial significant discretionary power on key strategic decisions, which provide a crucial baseline for possibility of expropriation. Controlling shareholder will ensure that the management will serve on their behalf, hence actions and policies made by the management would lead to their interest (Anderson and Reeb, 2003). As Malaysia is classified as having high concentrated ownership with the presence of controlling shareholder, it is interesting to infer how severe the problem of expropriation is by the controlling shareholders in this country.

The presence of large shareholders and the role played by them is very important in order to minimize the vulnerability of expropriation. Large shareholders use their power and incentive to avoid possibility of expropriation by controlling shareholder that benefit to other shareholders (Mitton, 2002; Attig et al., 2009; Gomes, 2000). Previous works have documented that the presence of large shareholders in the firm implies the existence of contestability among large shareholders including controlling shareholder to gain control in the firm and this will benefit other shareholders (Pagano

and Roell, 1998; Bennedsen and Wolfenzon, 2000; Bloch and Hege, 2000; Maury and Pajuste, 2005; Gomes and Noveas, 2005). In addition, the presence of more than one large shareholder will enhance the value of the firm (Pagano and Roell, 1998; Bennedsen and Wolfenzon, 2000; Maury and Pajuste, 2005; Laeven and Levine, 2008), significantly reduce agency cost (Isakov and Weisskopf, 2009) and reduce the corporate expropriation (Maury and Pajustee, 2002; Giterrez and Tribo, 2003; Maury and Pajustee, 2005; Attig et al., 2008).

The monitoring role is very important task that should be carried out by large shareholders and it will be a viable solution to agency problem (Grossman and Hart, 1980; Shleifer and Vishny, 1986). The existence of more than one large shareholder and the contestability against controlling shareholders in order to gain control will lessen the possibility of expropriation. Empirical evidence have validated that contestability among large shareholders will benefit other shareholders (Zwieble, 1995; Pagano and Roell, 1998; Bennedsen and Wolfenzon, 2000; Gomes and Noveas, 2000; Bloch and Hege, 2000; Maury and Pajuste, 2005). Therefore the role of large shareholders is very important to ensure that the action taken by the firm will not only benefit the controlling shareholder (Attig et al., 2008; Ramli, 2010; Bennedsen and Wolfenzon, 2000; Berger, Ofek and Yermack, 1997). They have a right to monitor the controlling shareholders to ensure that every action taken will also provide benefits to all shareholders (Grossman and Hart, 1980; Shleifer and Vishny, 1986; Pagano and Roell, 1998; Bennedsen and Wolfenzon, 2000; Gomes, 2000). Therefore, this study will investigate the issues of ownership structure focusing on contestability of large shareholders that could have significant impact on corporate expropriation.

Furthermore, this study also includes the effect of board governance on the corporate expropriation. This is vital due to the linkage between shareholders and

directors since the board of directors is elected by the shareholders. Notably, the board of directors is the highest governing authority in the management structure of a public listed company. Board of directors plays an important role to lead the company and to ensure that its main responsibility is well executed. Previous studies on board of directors focused on their impact to the performance of the firm (Adam and Mehran, 2005; Elsayed, 2007; Ponnu, 2008; Abidin, Kamal and Jusoff, 2009; Belkhir, 2009) but limited studies focused on the policies of the firm (Saad, 2010; Heng, Azrbaijani and San, 2012).

According to Bethel et al. (1998) the motive of the investors who purchased large block of shares is to control the firm so that they can influence firm's policies. In this respect, Croqvist and Fahlenbrach (2009) stated that shareholders can influence corporate policies directly by appointing directors who can represent them in the board of directors. A strong board of directors can play a monitoring role by ensuring that the management does not take any action that can negatively affect shareholder's wealth (Howton, Howton and Olson, 2001). This will also ensure that the investors' assets are protected as well as minimize the vulnerability of corporate expropriation, hence all shareholders will get appropriate returns and investors' confidence will increase.

Most of the previous studies on board of directors are directed towards understanding the influence of its structure and its relationship with firm's performance. This study is designed in a similar framework but specifically intended to examine its relationship with the corporate expropriation. Thus, this study suggests that boards should be structured according to corporate governance best practices recommendations. For example, at least one third of the board should consist of independent directors in order to obtain independence and professionalism. Therefore,

the independent directors' presence in the board is important to ensure that any action or decision taken is not dominated by the directors representing the controlling shareholders. Hence, the role of the board is to reduce the potential agency problem and the vulnerability of corporate expropriation through monitoring, representation and oversight responsibilities. Thus, this study intends to investigate whether the board structure, board diversity and board remuneration will have significant impact to minimize the vulnerability of expropriation.

Expropriation can be defined as illegal removal of asset, wealth and profit by controlling shareholders using their power of control in the firm at the expense of other shareholders for their own benefit (Shleifer and Vishny, 1997; Singhai, 2002; Sulong and Mat Nor, 2008). Basically, there are various forms of expropriation such as profit expropriation, tunneling of assets and improper dilution of ownership (Singhai, 2002), related party transaction (Harto, 2012) and inefficient investment by concentrated ownership structure (Shleifer and Vishny, 1997; Sulong and Mat Nor, 2008). This study intends to use profit expropriation through dividend payout as a proxy for expropriation of wealth by controlling shareholders to address the issue of agency problem and catering theory of dividend. Dividends are used as a proxy because there is no consensus regarding the best proxy to measure the expropriation by controlling shareholder depicted in agency problem (Banchit and Locke, 2010). In addition, dividend payout is one of the most crucial conflicts of interest between management and shareholders as explained by free cash flow problem and agency problem (Jensen, 1986). Previous studies also proposed that dividends can alleviate the free cash flow problem and agency problem in the firms. Dividends are also seen as an important component of investment return to the shareholders.

Dividends have been demonstrated in past studies as providing evidence of how controlling shareholders expropriate firm's wealth at the expense of minority shareholders. Controlling shareholders will prefer to keep earnings within the company and pay lower dividend in order to ensure that they have easy access to expropriate for their own private benefit (La Porta et al., 2000; Pinkowitz, Stulz and Williamson, 2006; Saez and Gutierrez, 2015). Tunneling activities by controlling shareholder such as self-dealing transaction occurs at the expense of minority shareholder (Bae, Kang & Kim, 2002) and will result in lower dividend payout. Classen et al. (2000) argued that controlling shareholders will extract profit for their private benefit and transferring profit to their affiliate companies by paying low or no dividend to shareholders. Past studies also documented that highly concentrated ownership, low dividend payments and lower firm valuation is a result of expropriation by controlling shareholder (Classen et al., 2000; Facio and Lang, 2001; La Porta et al., 2002).

According to the literature, Malaysian PLCs have highly concentrated ownership structure with the presence of controlling shareholder. As this could expose to the high risk of expropriation, it provides a motivation to conduct expropriation research on Malaysian PLCs. This study investigates the effects of contestability of large shareholders against controlling shareholder and the board governance in Malaysian PLCs and their impact on corporate expropriation measured by dividend payout.

### **1.3 Research Questions**

The earlier section indicates the role of ownership relating to corporate expropriation. Based on the discussion in the problem statement earlier, the following research questions are developed for this study.

- a. Does the presence of only controlling shareholder has significant impact on corporate expropriation?
- b. Does the presence of large shareholders have significant impact on corporate expropriation?
- c. Does board structure have significant impact on corporate expropriation?
- d. Does board diversity have significant impact on corporate expropriation?
- e. Does board remuneration have significant impact on corporate expropriation?

#### **1.4 Objectives of the Study**

The main objective of this study is to investigate whether the presence of MSS and the board governance will have significant impact on the corporate expropriation of Malaysian PLCs. This broad objective can be achieved through the following specific objectives of the study:

- a. To investigate whether the presence of only controlling shareholder influences corporate expropriation.
- b. To examine whether the presence of large shareholders influences corporate expropriation.
- c. To identify the relationship between board structure and corporate expropriation.
- d. To examine the relationship between board diversity and corporate expropriation.
- e. To investigate the relationship between board remuneration and corporate expropriation.

### **1.5 Scope of Study**

This research attempts to investigate the impact of ownership structure focusing on contestability of large shareholders and board governance on corporate expropriation of a firm. Malaysian Public Listed Companies (PLCs) are selected as the sample in the study due to the availability of the relevant data. The period of the study is from 2008 to 2012 because of amendments of MCCG (revised 2007) to further strengthen corporate governance practice especially pertaining to the appointment of independent directors. Furthermore, due to more than 400 firms will be available in the sample, the 5-year period is considered adequate.

### **1.6 Significance of the Study**

This study is expected to provide a better understanding on the corporate governance mechanism especially on ownership structure and board governance by focusing on contestability and board of directors that served as the important internal mechanisms in corporate governance. This study will offer insights on how ownership structure and the board of directors play an important role in influencing the expropriation of the firm. Ownership structure and board of directors are crucial in providing guidelines and information to potential investors, researchers, regulators as well as policy makers such as Bursa Malaysia and Securities Commission.

As mentioned in earlier sections, many large firms collapsed due to weaknesses of corporate governance especially regarding the internal mechanisms. Therefore, this study focuses on the investigation of the impact of contestability of large shareholders against controlling shareholder and board governance on expropriation in the firm. It analyzes the role and the existence of large shareholders and the board governance in influencing the expropriation in the company. The findings of this study will enhance the understanding of the role played by large shareholders and controlling shareholder.



Unlike many previous studies which normally focus on the type of the ownership structure, this study considers the contestability of large shareholders against controlling shareholder in order to gain control in the firm. In addition, the role played by board governance variables can further enhance the understanding of expropriation of the company which is not influenced by certain groups of shareholders (controlling shareholder).

By focusing on the contestability large shareholders against controlling shareholder in Malaysia, this study extent the current literature on the role played by different groups of shareholders in highly concentrated ownership structure from the perspective of MSS. Furthermore, it further enriches the literature on agency theory, specifically when the ownership structure is highly concentrated. From the theoretical perspective, the findings of this study are expected to provide further explanations on the agency problems between controlling shareholders and other large shareholders. The research framework in this study offers a combination of two internal mechanisms in corporate governance which is developed based on the ownership structure and board governance in explaining corporate expropriation. Moreover, this study also provides additional evidence on agency problems based on contestability in order to gain control in the firm which includes firm with controlling shareholders and firm without controlling shareholders.

Therefore, the findings of this study add value to Bursa Malaysia and Securities Commission as a guideline in designing a proper governance mechanism.

## **1.7 Organization of The Thesis**

This thesis is divided into seven chapters. This chapter describes the background of the studies, problem statement, research questions, research objectives and definition

of key term. The second chapter is a special chapter describing the corporate ownership structure of Malaysian PLC's. In this chapter, it introduces the equity market, corporate ownership structure including their composition and also existence of MSS, corporate expropriation and the development of corporate governance in Malaysia. Chapter three provides a review on previous work pertaining to this research in order to shape the framework of this study. In chapter four, hypotheses to be tested are formulated based on the literature review and the research framework of the study. Chapter five reports the main empirical findings and the analysis of the findings. Chapter six provides detailed discussion on the empirical findings of the study. Chapter seven discusses the conclusion, implication of the study and limitation of the study as well as provides suggestions and recommendations for future research.

## **1.8 Definition of Key Terms**

There are several key terms used in this study that require understanding in terms of definition, meaning and concept. The commonly used terms are as follows:

- Multiple Shareholder Structure (MSS)

Multiple shareholder structure refers to the concentrated ownership structure in which shares are held by a group or a few large shareholders who control the company. This means that the ownership structure owned by the largest shareholders accompanied by other large shareholders or a few large shareholders.

- Blockholders/large shareholders

Blockholders or a large shareholder refers to the individual or institutions who owned 5% or more of direct and indirect ownership shares of total outstanding shares.

- Single Controlling Shareholders (SCS)

A single controlling shareholder refers to the individual or institution which holds a sizable amount of shares in a company. Specifically, it refers to the largest shareholder in the firm who owns more than 33% of outstanding shares. In effect, those who own more than 33% shares are allowed to have significant influence on corporate decisions in the company. This is applicable to companies with one controlling shareholder (at least or greater than 33%) and with no large shareholders (at least or greater than 5% but less than 33%). This is based on the threshold issued by Securities Commission where the shareholders who hold at least 33% of outstanding shares will have adequate controlling right on the management or to control the composition of a majority of the board of directors of such company (Bursa Malaysia). Largest shareholder or group of large shareholders who owns a minimum of 33% could have significant influence on corporate decisions.

- Corporate Governance

Corporate governance refers to a system that controlled and directed for a company in broader perspective which will require a good relationship of all stakeholders in managing a company successfully. It is an internal control mechanism system that influences management behavior to guarantee a high value of the owners' equity in the firm.

- Corporate expropriation

Corporate expropriation can be defined as illegal behavior of controlling shareholders or management who misuse their power of control in the firm to transfer company assets and profit to themselves at the expense of other shareholders. Thus, expropriation tends to occur when the controlling

shareholder has both the ability and incentive to generate private benefit at the expense of other shareholders.

- Ownership Structure

Ownership structures identify who is the shareholder and who are the controlling shareholders that control the firm and it can either be dispersed or concentrated. Dispersed ownership structure exists when the firm is owned by a lot of shareholders while concentrated ownership structure occurs when majority of the shares are owned by several large shareholders.

- Board Governance

Board governance is related to the board of directors such as board structure, board diversity and board remuneration.

- Board Structure

In general, board structure refers to three characteristics of board of directors which are board size, board composition and board leadership. These characteristics are used to capture the monitoring ability of the board and determine the effectiveness of its governing duties.

- Board Diversity

In general, diversity can be defined as all aspects of demographic characteristics, backgrounds and experiences. Some corporations describe diversity as differences of viewpoint, professional experiences, education, skills and other individual qualities and attributes that contribute to board heterogeneity, whereas some corporations view it as a concept of race, gender and national origin.

- Board Remuneration

Board remuneration refer to the rewards to the board of directors which include fee, salary, bonus and benefits in-kind. The remuneration package includes the fee for non-executive directors and the total package for executive directors.

## **CHAPTER 2**

# **CORPORATE OWNERSHIP STRUCTURE, CORPORATE GOVERNANCE AND CORPORATE EXPROPRIATION IN MALAYSIA**

This chapter discusses the corporate ownership structure and corporate governance mechanisms of Malaysian PLCs. The first section provides the overview of the Malaysian equity market. The second section introduces the corporate ownership structure in Malaysia by providing an overview of ownership concentration, composition and two distinct types of corporate ownership structure. The third section focuses on multiple shareholder structure. The fourth section discusses the issues of corporate expropriation in Malaysia. The fifth section discusses the corporate governance mechanism related to ownership and the sixth section discusses the dividend policy in Malaysia. The final section provides the summary of the chapter.

### **2.1 Overview of the Malaysian Equity Market**

The capital market consists of equity market, private and public debt securities market and financial derivatives market. Among the participants in the market are investors, issuers and market institutions. The Kuala Lumpur Stock Exchange (KLSE) was established on December 14, 1976 after the termination arrangement of currency between Malaysia and Singapore. KLSE changed its name to Bursa Malaysia on April 14, 2004 in order to be more customer-driven and market-oriented as a respond to

global changes and to enhance competitiveness. The Capital Market Master Plan was launched by Securities Commission in October 1999 to strengthen and to provide direction for the Malaysian capital market for the next ten years. It also seeks to ensure that the Malaysian capital market is able to meet future challenges successfully.

Bursa Malaysia is one of the largest bourses in Southeast Asia that offers a variety of investment alternatives to investors. Initially, Bursa Malaysia board structure consists of the Main Board, the second Board and the MESDAQ market. The Main Board comprised of established and large companies, the Second Board is for relatively smaller companies while the MESDAQ Market is for the high growth and technology companies. The Second Board and the MESDAQ Market were established as a starting point for relatively small companies to access capital to raise fund for their future expansion. Companies listed on the Second Board or the MESDAQ can be transferred to the Main Board when it meets listing criteria established for listing on the Main Board.

However, beginning 3<sup>rd</sup> September, 2009 Bursa Malaysia and the Securities Commission implemented a new framework for listing and equity fund raising which is considered as the one of the major changes to the capital market. Bursa Malaysia introduced a new board structure to the investors and issuers which only results in two markets instead of three markets previously. The new structure consists of the Main Market which combined both the Main Board and the Second Board while the ACE Market replaced the MESDAQ Market. The Main Market comprised of established companies in terms of their track record and size. Table 2.1 shows the key changes of the entry requirements in the Main Market. In contrast, the ACE Market serves as an alternative market for companies from all businesses and economic sectors. The new restructuring of Bursa Malaysia was designed so that the investors can have efficient

access to the capital market. This restructuring is also expected to make Bursa Malaysia a more attractive platform for both local and foreign companies, and to make Malaysia more competitive internationally.

Table 2.1  
Key Amendments to Entry Requirements

Listing route	Previously	Now (Main Market)
Profit test	<ul style="list-style-type: none"> <li>• Main Board <ul style="list-style-type: none"> <li>- Aggregate after-tax profit of RM 30mil over 3-5 financial years (FYs), with at least RM8mil after-tax for the latest FY</li> </ul> </li> <li>• Second Board <ul style="list-style-type: none"> <li>- Aggregate after-tax profit of RM12mil over 3-5 FYs, with at least RM4mil for the latest FY</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Aggregate after-tax profit of RM20mil over 3-5FYs, with at least RM6mil after-tax profit for latest FY</li> </ul>
Market capitalization test	<ul style="list-style-type: none"> <li>• Market capitalization of at least RM500mil and at least RM30mil after-tax profit for the latest FY; and</li> <li>• Operating history of at least 3FYs in the same core business</li> </ul>	<ul style="list-style-type: none"> <li>• Market capitalization of at least RM500 mil remains but no profit requirement for the latest FY</li> <li>• Only need to have a minimum of 1 FY operating revenue</li> </ul>
Infrastructure project corporation (IPC)	<ul style="list-style-type: none"> <li>• Project cost of at least RM500mil with remaining concession/license period of at least 15 years</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum project cost of RM500mil remains but the Securities Commission (SC) may consider a listing proposal with a shorter remaining concession/license period for IPCs that fulfill the profit test</li> </ul>
Note: under the SC new Equity Guideline, there will no longer be any requirement on minimum issued and paid-up capital		

Source: Securities Commission



The Main Market consists of 860 listed companies, while the ACE Market contains 117 listed companies. Currently there are 14 industries under the Main Market as list shown in Table 2.2.

Table 2.2  
Numbers of Malaysian PLCs by Industry

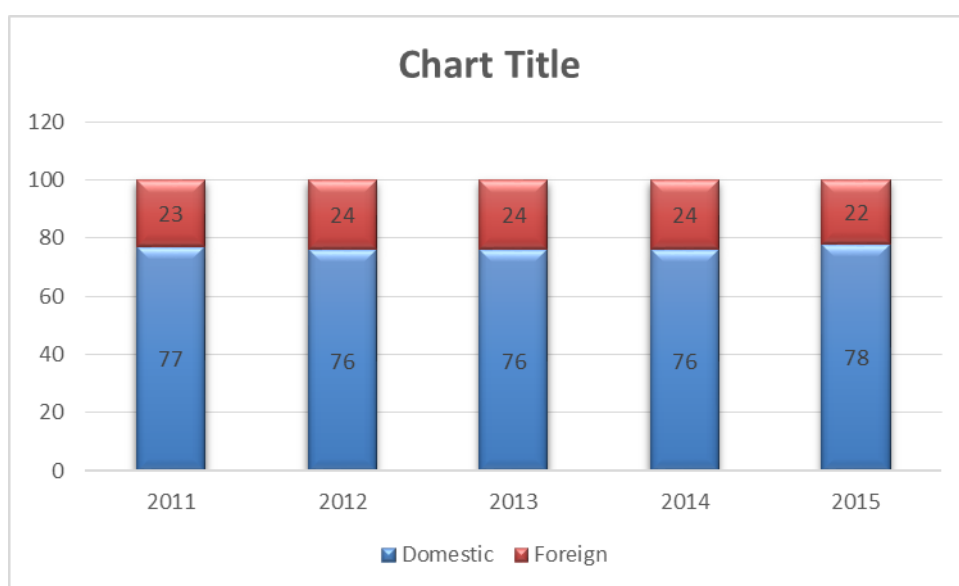
Industry	Number of Companies	Percentage
Industrial Products	262	30.5
Trading / Services	178	20.7
Properties	88	10.2
Consumer Products	141	16.4
Constructions	47	5.5
Finance	38	4.4
Plantations	41	4.8
Technology	32	3.7
Reits	14	1.6
Infrastructure	7	0.8
Hotels	5	0.6
Exchange Traded Fund	5	0.6
Mining	1	0.1
Closed-End Fund	1	0.1
<b>Total</b>	<b>860</b>	<b>100</b>

Source: The Star 2011

As shown in Table 2.2, most of the companies are listed under the five main industries which is equivalent to 78% of the total numbers of listed companies. The five main industries comprise of industrial product (30.5%), trading/services (20.7%), properties (10.2%) consumer products (16.4%) and construction (5.5%). Other industries only accounted less than 5% each to the overall number of listed companies.

Figure 2.1 shows the distribution of ownership in Malaysian PLCs among local investors and foreign investors from 2011 until 31 December, 2015 (Bursa Malaysia Annual Report 2015). The highest ownership of foreign investor is recorded in 2012, 2013 and 2014 with shareholding of 24%. The local investors still dominate the ownership of PLCs in Bursa Malaysia with an average shareholding of 77%.

Figure 2.1  
Distribution of Share Ownership of Malaysian PLCs.



Source: Bursa Malaysia Annual Report 2015

## 2.2 Corporate Ownership Structure of PLC

Ownership structure is one of the important mechanisms in corporate governance. Corporate governance arises because of the separation of ownership (shareholders) and control (decision maker) in a firm. The composition of ownership structure will determine who control the firm or who the ultimate shareholders are. Controlling shareholders can be defined as a person or a group of persons who together is entitled to exercise or control the exercise of at least 33% of the voting right shares in a company or who in a position to control the composition of a majority of the board of

directors of such company (Securities Commission Malaysia, Equity Guideline August 2009). In addition, according to Bursa Malaysia Main Market Listing shareholding spread (Bursa Malaysia, 2009), PLCs should ensure that at least 25% of their outstanding share or a minimum number of 1,000 shareholders must be owned by public shareholders with not less than 100 shares each.

### **2.2.1 Ownership Concentration**

In general, Malaysian PLCs are classified as having concentrated ownership structure (Claessens et al., 1998; Claessens et al., 2000 and World Bank, 1998). According to World Bank (1998) small groups and related parties dominated majority of the shares in the PLCs and 85% had owner-managers. It was reported that on average, five largest shareholders owned 60.4% of outstanding shares and more than half of voting shares. In addition, 37.4% of the companies have one dominant shareholder, 67.2% of the shares are controlled by family ownership and 13.4% of the shares are in the hand of the state. A study by ADB s (2000) reveals that the largest shareholders control 30.3% of the shares, while the top five largest shareholders control 58.8% and the top 20 shareholders control 80% of all Malaysian PLCs as of the end of 1998.

Claessens et al. (2000) analyzes 2,980 corporations in nine East Asian countries and found that most of the companies are controlled by single owner. Out of the total 66 Malaysian PLCs in the sample, they found that 41 companies belong to family groups. This shows that ownership structure in Malaysia is highly concentrated and therefore consistent with the study by Abdul Samad (2002), which has a total sample of 731 companies and found that ownership of Malaysian PLCs is controlled by a few